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“REGULATORY PRINCIPLES FOR SOUTH AFRICA”

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**The views and ideas expressed here are offered in my private capacity.*

- **The trend towards the Regulatory State.**

It has been argued that:

“A fundamental driver of the demand for regulation in recent years has been increasing ‘risk aversion’ in many spheres of life. Regulation has come to be seen as a panacea for many of society’s ills and as a means of protecting people from inherent risks of daily life. Any adverse event ... is laid at government’s door for a regulatory fix”. (Banks, 2006, p. 11)

- **This approach is being increasingly questioned by organisations such as OECD.**

Considerable attention is now devoted to regulatory impact analysis and to the principles of efficient regulation

- Use these principles as a common foundation for all economic regulation in South Africa?
- Administer these principles through a **National Regulatory Authority?**

- Each industry regulator would build its own specific regulatory model on, and consistent with, this foundation?
- The **National Regulatory Authority** could monitor individual regulator compliance with the fundamental principles.
- Economic regulation: regulation which is designed to improve the operation of the economy in ways which include greater efficiency, increased productivity.
- What are these principles, and what are the highly important issues in economic regulation? [Please note that many of these are already part of the public regulatory process in South Africa].
- **The benefits of regulation should exceed the costs.**

Some people argue that governments should intervene in economic affairs when there is market failure. Market failure is, however, not a sufficient basis for regulation. If the compliance and other costs of regulation exceed the benefits of that regulation, then the economy loses. A degree of market failure is unavoidable in what is an imperfect world because it costs too much to eliminate it, or even reduce it significantly in certain cases.

A caveat ought to be entered here. A regulation which confers benefits on one party may impose costs disproportionately on another without compensation. Even though, at an aggregate level, the benefits may exceed the costs in this case, the regulation may not be acceptable on equity grounds unless compensation arrangements are feasible.

- **The doctrine of competitive neutrality should be applied.**

Competitive neutrality means that public sector business organisations which compete with the private sector should not normally have competitive advantages, or disadvantages, by virtue of their government ownership or control.

- **Economic regulation can embrace the regulation of service quality,**

Performance standards are typically involved here. Appropriate minimum standards are best determined through a process which includes public consultation.

- **The nature and extent of regulation should be proportionate to the severity of the matters to be addressed.**

Proposals for highly prescriptive forms of regulation need to be evaluated thoroughly.

- **There is sometimes a choice to be made between incentive-based, market oriented instruments and command-and-control instruments.**

Careful consideration needs to be given to which matters are best regulated by incentive-based, market oriented instruments, which are best handled by command-and-control instruments, and which are most efficiently regulated by a mix of instruments. The potential for self-regulation also needs to be considered. Any agreements negotiated through self-regulation processes will need oversight by regulators in terms of the public interest. A National Regulatory Authority should issue guidelines regarding how the choice of regulatory instruments should be made by industry regulators in order to ensure national consistency.

- **Regulatory Impact Statements [RIS].**

In many international jurisdictions, if a proposed regulation is likely to impose appreciable costs on the community, or part of the community, a Regulatory Impact Statement (RIS) must be prepared before the regulation is made. Its purpose is to explain the need for the regulation and to set out the benefits and costs which would flow from its adoption. It also explains if any alternatives to regulation were considered and why they were rejected. Sometimes an *ex post* RIS is produced whereby the actual costs and benefits of significant instances of regulation are determined in the light of experience.

- **Regulation and Competitive Behaviour**

A National Regulatory Authority might issue Guidelines as to which commercial practices are most likely to drive out potential competitors, increase costs to consumers and the economy at large. Such practices might include:

- Price gouging - Using monopoly power to charge excessive prices.
- Service bundling - Extending monopoly power in one area to another potentially competitive area. This is also referred to as tying arrangement.
- Increasing entry barriers - Constructing hurdles to increase the share of the market needed to operate at maximum efficient scale, raising absolute costs of entry, or by tending to foreclose competitors from needed resources or outlets.
- Raising rival's cost - Increasing the cost of services required by a rival to place him/her at a competitive disadvantage.
- Exclusive dealing - Requiring suppliers to sell only to them and not to any potential competitor.
- Predatory pricing - Selling services below cost to induce a rival's exit from the market, deter future entry or dissuade a rival from future competition.
- Price discrimination - Similar to predatory pricing in that selective price discrimination by a powerful seller can eliminate competition or otherwise entrench the discriminating seller's monopoly power.

- **Each of these practices, and others, must be evaluated in the particular case to establish if they are against the public interest and if a regulatory response is appropriate. There are instances where alleged anti-competitive behaviour, [for example, some forms of vertical integration], may not serve a predatory purpose but may be designed to reduce certain transactions costs.**

- **The assignment of responsibilities to individual industry regulators must be done in a way which minimises overlap between them.**

- **Regulating in pursuit of a given government policy objective in a given industry may inhibit the achievement of another [others].**

Where significant trade-offs between government policy objectives may arise in a regulatory process, serious consideration ought to be given to

inviting government to be independently represented in the relevant proceedings to define the dimensions of any necessary policy trade-offs.

- **An organisation subject to the regulation of one aspect of its activities may respond strategically and seek to circumvent the impact of regulation by altering prices, costs, contracts and so on in those of its activities which are not regulated. Regulators may respond in a “tit-for-tat” manner which may not be efficient.**
- **Industry, and other, pressures may be placed on regulators for regulation which favours certain interests.**

The literature on economic regulation raises the risk that regulators may be subject to attempts at external and/or internal “capture”. Oversight of these risks could well be one of the responsibilities of a National Regulatory Authority.

- **Regulators need to identify and to efficiently mitigate the risk that they will have far less relevant information than do regulatees.**
- **A regulator must avoid attempting to manage the functioning of a particular industry, of a section of any industry which is under its jurisdiction: regulation should focus on desirable public interest outcomes, not on the specific steps taken to achieve these outcomes.**
- **When regulators exercise their powers, circumstances may arise in which it is desirable for the regulator to issue a discussion paper and/or a preliminary statement of findings for stakeholder and public response.**
- **A National Regulatory Authority might commission independent, annual developmental evaluations of the performance of each regulator, and of the corporate governance processes implemented by each regulator.**

By the same token, overlap should be avoided here. The PFMA, and bodies such as the Auditor General, may provide all that is necessary to evaluate corporate governance outcomes.

- **South Africa's reputation as a destination for both domestic and foreign direct investment will be influenced by the credibility of its regulatory bodies.**

Each regulator might seek public submissions every 5 years on the quality and relevance of its regulatory policies and methods.

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